Independent Investor

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Make a Plan for Withdrawing Retirement Assets

You've worked long and hard to accumulate the assets that you are using to help finance your retirement. Now, it's time to start drawing down those assets. Exactly how you withdraw assets from various accounts will affect your taxes and impact how long those assets last, so it pays to plan a withdrawal strategy that is efficient and maximizes the benefits of different types of investments.

First: Take an Inventory

The first step in planning your withdrawal strategy is to take an inventory of all the assets you have accumulated for retirement, paying particular attention to distinguish between taxable accounts, such as ordinary bank or brokerage accounts, and tax-deferred accounts such as 401(k), 403(b) and 457 plans, and IRAs. From this process, you can begin to estimate how much cash you may be able to count on receiving from dividends, interest payments, redemptions, and distributions in a given year. You can also assess how much you will need to hold in reserve in order to meet your tax obligations.

If your total expected income from the assets in your taxable accounts is great enough to meet your budgeted cash needs for the year, consider yourself to be fortunate. You need not weigh the transaction costs of different asset sale strategies or consider the added income tax effects of withdrawing assets from employer-sponsored plans and IRAs. But if you do need to liquidate assets in order to meet your cash flow targets, then you should consider the plusses and minuses of each withdrawal strategy as outlined in the following savings withdrawal hierarchy.

Set Withdrawal Priorities

As you consider these options, keep in mind that no single plan can be right for every person and every situation. Among the additional issues you should consider when designing your withdrawal strategy are the management of portfolio risk, your tax bracket, and the cost basis of the investments.

With that in mind, below is a general summary of guidelines for creating an appropriate strategy. Remember, this is just an example. Your circumstances may require a different approach, so be sure to seek the help of a financial and or tax professional before taking any action. Note, too, that estate tax considerations might have an impact on your withdrawal priorities.

- Meet the rules for Required Minimum Distributions (RMDs). Owners of traditional IRAs and participants in 401(k), 403(b) and 457 plans must follow IRS schedules for the size and timing of their RMDs. Those who fail to do so face a penalty tax equal to 50% of any required distribution that has not been taken by the applicable deadline.

- Sell losing positions in taxable accounts. If you have an investment that is worth less now than when you bought it, you may be able to create a tax deduction by selling that investment. This deduction can be used to offset any investment gains you realize. It can also be used to offset up to $3,000 in ordinary income. Losses in excess of the limits can usually be carried forward for use in future years.

- Realize long-term gains from taxable accounts. When liquidating taxable account

- assets, liquidate the holdings with long-term capital gains--which are taxed at a maximum of 20%--before those with short-term gains--which typically are taxed at ordinary income tax rates, the highest of which is currently 39.6%.

- Withdraw assets from tax-deferred accounts to which nondeductible contributions have been made, such as traditional IRAs. If you ever made a nondeductible contribution to an IRA, then part of every withdrawal will be tax free. If you filed a Form 8606 with your tax return for every year you made a nondeductible contribution, the most recent of these should show the total amount of all nondeductible contributions. This amount represents your basis in your IRA, from which you can determine the percentage of your withdrawal that will be tax free. Your accountant or other financial professional can help you with this calculation.

These are just a few of the withdrawal strategies you may want to consider. Keep in mind that the IRS has exacting requirements for exploiting all of these strategies and that tax laws are always subject to change. You should review your retirement distribution strategies with your tax and investment advisors before taking any specific action.